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No. 97-915

In The

Supreme Court of the United States

October Term, 1997

AMBANC LA MESA LIMITED PARTNERSHIP,
a partnership,

Petitioner,

v.

LIBERTY NATIONAL ENTERPRISES, a partnership,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether the accumulated rents of $300,000 constitute part of Liberty's secured claim for purposes of determining whether the Plan satisfies 11 U.S.C. § 1129(b)(2).

2. Whether substantiality is an independent element of the new value exception or corollary to the absolute priority rule.

PARTIES TO THE PROCEEDING

The Petition for Writ of Certiorari accurately lists the parties to the proceeding. Respondent Liberty National Enterprises ("Liberty") is a closely held California limited partnership which has no parent company or any subsidiaries or affiliates.

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OPINIONS OF LOWER COURTS

After several evidentiary hearings the United States Bankruptcy Court for the District of Arizona ("Bankruptcy Court") issued a Minute Entry dated March 24, 1992 confirming Ambanc La Mesa Limited Partnership's ("Debtor") Second Amended Plan of Reorganization ("Plan") and directing Debtor's counsel to lodge a separate confirmation order consistent with the ruling. (E.R. 268A) The Minute Entry has not been officially reported and is reprinted in the appendix hereto at page A.1. In all other material respects the Petition for Writ of Certiorari accurately reflects the opinions delivered in this case by other courts.

STATUTES INVOLVED

11 U.S.C. § 1129(b) which provides:

> (b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.
>
> (2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements;

(A) With respect to a class of secured claims, the plan provides:

(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims –

(i) The plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

(C) With respect to a class of interests –

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

In all other material respects the Petition for Writ of Certiorari accurately reflects the statutes involved.

STATEMENT OF THE CASE

Liberty hereby incorporates the facts recited in its opening brief and the subsequent Opinion issued by the Ninth Circuit.

With regard to Debtor's Statement of the Case, Liberty disputes certain of the factual recitations as incomplete or inaccurate. Specifically, by Order dated March 8,

1991, the Bankruptcy Court valued *only* the real property securing Liberty's claim at $4,300,000 (E.R. 108).

Debtor improperly references the certain new promissory notes allegedly executed by the Class 9 claimants. Petition, p. 7. However, no such promissory notes are part of the record below or were offered into evidence by Debtor at any of the evidentiary hearings.

Debtor erroneously states that the only claims discharged under its Plan are $5,647.00. Petition, p. 7. Debtor, however, acknowledges that Liberty's Class 5 claim will only be paid the principal amount of its claim *without interest*. Petition, p. 7. The Ninth Circuit concluded that the amount of the debt discharged under the Plan included, *inter alia*, the interest on Liberty's Class 5 claim which was not paid under the Plan. *Ambanc*, 115 F.3d at 656. The Ninth Circuit in *Ambanc* reasoned:

> At, for instance, the rate of interest the Plan applies to Liberty's secured claim – 10.5% – potentially over ten years, this lost interest could exceed $4 million.

Ambanc, 115 F.3d at 656.

Debtor improperly asserts that the Ninth Circuit reversed and remanded the matter to the Bankruptcy Court. Petition, p. 8. In actuality, the Ninth Circuit simply reversed the Confirmation Order *without* remanding the matter to the Bankruptcy Court. *Ambanc*, 115 F.3d at 657.

REASONS WHY THE PETITION FOR WRIT OF CERTIORARI SHOULD BE DENIED

I. THE ACCUMULATED RENTS OF $300,000 CONSTITUTE PART OF LIBERTY'S SECURED CLAIM FOR PURPOSES OF DETERMINING WHETHER THE PLAN SATISFIES 11 U.S.C. § 1129(b)(2)

Debtor erroneously asserts that *Ambanc* is inconsistent with *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365, 108 S. Ct. 626, 98 L. Ed. 2d 740 (1988).[1] Unlike *Ambanc*, however, *Timbers* did not address the issue of whether a plan of reorganization satisfied the cram down standards of 11 U.S.C. § 1129(b)(2). *Timbers* arose in the context of a secured creditor's motion for relief from the automatic stay. *Timbers* did not address the issue of valuation of a secured claim pursuant to 11 U.S.C. § 506(a) or how to treat accumulated rents in valuing the secured claim for purposes of cram down. Rather, *Timbers* dealt with the discrete issue of whether a undersecured creditor was entitled to post-petition interest on its collateral during the stay to assure adequate protection. *Timbers*, 484 U.S. at 369.[2] This simply was not an issue on appeal in *Ambanc*. Thus, to the extent that it is even relevant, *Timbers* is not inconsistent with *Ambanc*.

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[1] *Timbers* was not cited by either the District Court or the Ninth Circuit.

[2] In *Timbers* the respondent debtor "had agreed to pay petitioner the post-petition rents from the apartment project (covered by the after acquired property clause in the security agreement), minus operating expenses." *Timbers*, 484 U.S. at 368-69. Thus, the debtor in *Timbers* sought the "use value" of the property in addition to the post-petition rents.

Timbers did, however, implicitly recognize that an assignment of rents represents a security interest which is separate and distinct from the mortgage on the real estate and that each interest deserves adequate protection. *Timbers*, 484 U.S. at 374. Other courts have been more explicit in recognizing the separateness of the two security interests. *See, In re Gramercy Twins Associates*, 187 B.R. 112 (Bankr. S.D.N.Y. 1995) (post-petition payments by the debtor to the secured creditor should not be applied against the secured portion of the claim; rather, payments must be considered protection for the separate interest in rents in accord with § 552(b) and be credited only against the total allowed amount of the claim, indirectly reducing the unsecured portion of the claim); *In re Bloomingdale Partners*, 155 B.R. 961 (Bankr. N.D. Ill. 1993) ("taken together, sections 506(a) and 552(b) require that [the creditor's] post-petition security interest in rents be added to its separate security interest in the Property"); *Federal Nat'l Mortgage Ass'n v. Dacon Bolingbrook Assoc. L.P.*, 153 B.R. 204 (N.D. Ill. 1993) (Fannie Mae possesses a distinct, additional interest in the rents which must be adequately protected from a reduction in value); *In re Vermont Inv. Ltd. Partnership*, 142 B.R. 571 (Bankr. D.D.C. 1992) (because the mortgage and assignment of rents were distinct interests of the creditor, payments made pursuant to a cash collateral order designed to protect an assignment of rents should not be deducted from the creditor's secured claim); *In re Financial Ctr. Assocs. of East Meadow, L.P.*, 140 B.R. 829 (Bankr. E.D.N.Y. 1992) (creditor entitled to adequate protection of two distinct interests; its mortgage on the property and its right to collect rents flowing from the property or, at the very least, its security

interest in such rents); *In re Flagler-at-First Assocs.*, 114 B.R. 297 (Bankr. S.D. Fla. 1990) (post-petition payments pursuant to a cash collateral order should not be deducted from the amount of the secured claim because the secured creditor was entitled to protection of its separate interests in the property and the rents). Consistent with this line of cases, *Ambanc* simply added the value of the security interest in the real property ($4,300,000) and the value of the separate security interest in the accumulated rents ($300,000) to arrive at a value for Liberty's secured claim ($4,600,000) for purposes of cram down.

Debtor erroneously asserts that there is a split of authority between the Ninth Circuit in *Ambanc* and the Fifth Circuit in *In re T-H New Orleans Ltd. Partnership*, 116 F.3d 790 (5th Cir. 1997). There is no such split of authority. Debtor asserts that these circuit courts differ in their analysis of 11 U.S.C. § 506 and the application of *Timbers*. Petition, p. 10. This is nothing more than Debtor's fundamental misunderstanding of both the facts and the holding in *T-H New Orleans*.[3] Like *Ambanc*, *T-H New Orleans* held that the amount of a secured claim is not limited to the petition date – post-petition rents increase the amount of the secured claim.[4] *T-H New Orleans*, 116 F.3d at 798. In

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[3] The Fifth Circuit in *T-H New Orleans* noted that "the Timbers Court was not confronted with the question we are presented today. We note that the creditor in Timbers was undersecured at the time of its adequate protection hearing and the appeal to this Court, and the value of the collateral was not increasing and there was no evidence that future appreciation would provide for post-petition interest." *T-H New Orleans*, 116 F.3d at 797.

[4] Unlike *Ambanc*, the secured creditor in *T-H New Orleans* was receiving post-petition pre-confirmation monthly cash

doing so, the Fifth Circuit in *T-H New Orleans* adopted a "flexible approach" and declined to follow a narrow approach limiting the value of a secured claim to a single point in time. *T-H New Orleans*, 116 F.3d at 798. The Fifth Circuit in *T-H New Orleans* reasoned that a flexible approach to valuing a secured claim recognizes that any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, and not the debtor. *T-H New Orleans*, 116 F.3d at 798; *See also, Dewsnup v. Timm*, 502 U.S. 410, 417, 112 S. Ct. 773, 778, 116 L. Ed. 2d 903 (1992) (any increase over the judicially determined valuation during the bankruptcy rightly accrues to the benefit of the creditor, not the benefit of the debtor and not to the benefit of other unsecured creditors whose claims have been allowed and who had nothing to do with the mortgagor – mortgagee bargain). As to this discrete issue, *Ambanc* and *T-H New Orleans* are not "diametrically opposed." The mere fact that *Ambanc* resulted in the reversal of a confirmation order and that *T-H New Orleans* resulted in the affirmance of a confirmation order does not suggest otherwise.

Debtor incorrectly assumes that Liberty's separate perfected security interest in the accumulated rents is necessarily subsumed within the value of the real property. Petition, p. 13. The fact that a prior appraisal utilized a discounted cash flow analysis fails to support this conclusion. The appraisal was dated as of July 20, 1990 and Debtor readily acknowledges that the accumulated rents of $300,000 "[were] not in existence at the time of the

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collateral payments. These cash collateral payments were then subtracted from the secured creditor's *allowed* claim.

valuation." Petition, p. 11. Thus, the accumulated rents could not possibly be subsumed within the value of the real property. To hold otherwise, or to adopt the anomaly proposed by Debtor (i.e., simply add the value of the accumulated rents to the collateral for the secured claim *rather than* to the value of the secured claim) would be to render both 11 U.S.C. §§ 506(a) and 552(b) practical nullities and theoretical absurdities.

Whether or not Liberty requested a revaluation of its collateral at the time of confirmation is immaterial. First, there was no dispute that as of the effective date of the Plan there was approximately $300,000 in accumulated rents. (E.R. 165, at p. 30) Thus, there was no reason to request an additional valuation hearing simply to determine the undisputed value of the accumulated rents. Second, Liberty objected to confirmation of Debtor's Plan on the ground that, *inter alia*, the Plan was not fair and equitable having failed to take into account Liberty's separate perfected security interest in the accumulated rents. Debtor had the burden to prove by a preponderance of the evidence that its Plan satisfied all the requirements of 11 U.S.C. § 1129, including the cram down standards. *In re Arnold and Baker Farms*, 177 B.R. 648 (9th Cir. BAP 1994), *aff'd*, 85 F.3d 1415 (9th Cir. 1996), *cert. denied*, 117 S. Ct. 681 (1997). The Bankruptcy Court had an affirmative duty to ensure that the Plan satisfied all 11 U.S.C. § 1129 requirements for confirmation. *In re L&J Anaheim Assoc.*, 995 F.2d 940, 942 (9th Cir. 1993). Debtor failed to carry its burden and the Bankruptcy Court similarly failed to discharge its duty.

The only inconsistency is the position asserted by Debtor with respect to the date for valuing a secured

claim for purposes of cram down and the particular Bankruptcy Code provision governing this analysis. In October, 1990 Debtor filed a Motion for Valuation of Security ("Motion") seeking a valuation of the real property. (E.R. 51) A copy of the Motion is reprinted in the Appendix hereto at page A.4. The Motion, relying on 11 U.S.C. § 506(a) as its statutory predicate, states:

> It has been said that the value of the subject property should be determined as of the date to which the valuation relates. *For example, if the valuation is to determine the amount of a secured claim for purposes of a Chapter 11 plan of reorganization, the value should be determined as of, or close to, the effective date of the plan.*

A.7 (emphasis added). The Motion further states that the appraisal[5] "more closely approximates in time the effective date of the plan, which is currently anticipated as early 1991 and, therefore, more accurately depicts the value of the real property." A.7. Conspicuously absent in the Motion is any reference by Debtor to 11 U.S.C. § 502(b) and valuing the secured claim as of the petition date. The Motion is wholly inconsistent with Debtor's argument that the value of the secured claim should be determined as of the petition date. Debtor should be estopped from now asserting a contrary position before this Court.

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[5] The appraisal was dated as of July 20, 1990. The bankruptcy petition was filed May 30, 1990.

II. SUBSTANTIALITY IS A RECOGNIZED AND INDEPENDENT ELEMENT OF THE NEW VALUE EXCEPTION OR COROLLARY TO THE ABSOLUTE PRIORITY RULE

The Ninth Circuit in *In re Bonner Mall Partnership*, 2 F.3d 899 (9th Cir. 1993), *mot. to vacate denied and cert. dismissed*, 115 S. Ct. 386 (1994) adopted the new value exception or corollary to the absolute priority rule.[6] At the time *Bonner Mall* was the first circuit court decision to hold that the new value exception or corollary survived the enactment of the Bankruptcy Code. Since then the Seventh Circuit in *In re Matter of 203 N. LaSalle St. Partnership*, 126 F.3d at 955 (7th Cir. 1997) has also adopted the new value exception or corollary. Both *Bonner Mall* and *203 N. LaSalle St. Partnership* held that the new value exception or corollary requires that equity holders provide value to the reorganized debtor that is (1) new, (2) substantial, (3) in money or money's worth, (4) necessary for a successful reorganization, and (5) reasonably equivalent to the value or interest received. *Bonner Mall*, 2 F.3d at 908; *203 N. LaSalle St. Partnership*, 126 F.3d at 963. Both circuit courts have recognized substantiality as a separate

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[6] The Court has summarized the absolute priority rule as follows:

> "[A] dissenting class of unsecured creditors must be provided for in full before any junior classes can secure or retain any property under a reorganization plan."

Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 202, 108 S. Ct. 963, 966, 99 L. Ed. 2d 169 (1988) (internal quotation marks and brackets omitted).

and independent element of the new value exception or corollary.

Ambanc merely applied the recognized elements of the new value exception or corollary, including the substantiality element, to the facts of the case. In doing so, *Ambanc* held that only the $32,000 capital contribution made by the equity holders on the effective date of the Plan satisfied the money or money's worth element. *Ambanc*, 115 F.3d at 655. In evaluating the substantiality element *Ambanc* rejected the $32,000 capital contribution as a threshold matter because it was *de minimis* as a matter of law in comparison with any of the various quantities judicially recognized as relevant. *Ambanc*, 115 F.3d at 655, 656. Accordingly, *Ambanc* expressly declined to reach the necessity and reasonable equivalence elements of the new value exception or corollary.[7] *Ambanc*, 115 F.3d at 656.

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[7] Notwithstanding, *Ambanc* went on to briefly address both the necessity and reasonable equivalence elements:

> However, if a new Plan is proposed in the future and confirmed, the bankruptcy court's confirmation order will likely need to exhibit a more comprehensive factual determination as to necessity than is present in the order under review. The court must also take care that the equivalence analysis only compares what the partners put in to what they get out.

Ambanc, 115 F.3d at 656. Based on the record (or lack of record) it is clear that the Ninth Circuit would have reversed on these two elements and certain other independent confirmation requirements were there any reason to reach them.

The elements of the new value exception or corollary, including the substantiality element, have been developed through a substantial body of case law, relying in large part upon dicta from *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 60 S. Ct. 1, 84 L. Ed. 2d 110 (1939). *203 N. LaSalle St. Partnership*, 126 F.3d at 963; *Bonner Mall*, 2 F.3d at 906. The Court in *Case* held that the plan of reorganization proposed by the debtor was not fair and equitable as a matter of law. Nonetheless, the Court in *Case* went on to discuss certain circumstances under which existing stockholders may participate in a plan of reorganization of an insolvent debtor. The Court in *Case* firmly established the rule of absolute priority. Since *Case*, a substantial body of case law including *Bonner Mall*, *Ambanc* and *203 N. La Salle St. Partnership* has evolved holding that substantiality is one of the independent elements of the new value exception or corollary.[8]

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[8] *In re Woodbrook Assocs.*, 19 F.3d 312, 320 (7th Cir. 1994); *In re Snyder*, 967 F.2d 1126 (7th Cir. 1992); *In re U.S. Truck Co., Inc.*, 800 F.2d 581 (6th Cir. 1986); *In re Potter Material Serv., Inc.*, 781 F.2d 99 (7th Cir. 1986); *Berkeley Federal Bank & Trust v. Sea Garden Motel and Apartments*, 195 B.R. 294 (D.N.J. 1996); *In re Elmwood, Inc.*, 182 B.R. 845 (D. Nev. 1995); *Coones v. Mutual Life Ins. Co.*, 168 B.R. 247 (D. Wyo. 1994), *aff'd* 56 F.3d 77 (10th Cir. 1995); *In re BMW Group I*, 168 B.R. 731 (Bankr. W.D. Okla. 1994); *In re Wynnefield Manor Assocs.*, 163 B.R. 53 (Bankr. E.D. Pa. 1993); *In re Capital Center Equities*, 144 B.R. 262 (Bankr. E.D. Pa. 1992); *In re Sovereign Group 1985-27, Ltd.*, 142 B.R. 702 (E.D. Pa. 1992); *In re SLC Ltd. V*, 137 B.R. 847 (Bankr. D. Utah 1992); *In re Pullman Construction Industries, Inc.*, 107 B.R. 909 (Bankr. N.D. Ill. 1989); *In re Ashton*, 107 B.R. 670 (Bankr. D.N.D. 1989); *In re Kendavis Indus. Int'l, Inc.*, 91 B.R. 742 (Bankr. N.D. Tex. 1988).

Debtor erroneously contends that even if substantiality is an element of the new value exception or corollary then "the Ninth Circuit in *Ambanc* confused substantiality and what is reasonably equivalent in value to the interest retained." Petition, p. 19. Quite the contrary, *Ambanc* expressly held that "[w]holly *de minimis* contributions, however, simply fail the threshold analysis under the second prong, substantiality – *a requirement separate and independent of equivalence.*" *Ambanc*, 115 F.3d at 655 (emphasis added); *See also, In re Snyder*, 967 F.2d 1126, 1131 (7th Cir. 1992). *Ambanc* went on to further note that rejection of *de minimis* contributions is consistent with long standing precedent including railroad reorganizations dating back to the early part of the century. *Ambanc*, 115 F.3d at 656. It is Debtor, rather than the Ninth Circuit, which has confused the substantiality element with the reasonable equivalence element.

Debtor's reliance on *In re Haskell Dawes, Inc.*, 199 B.R. 867 (Bankr. E.D. Pa. 1996) is misplaced. *Ambanc* had no reason to even reach the reasonable equivalence element of the new value exception or corollary as the $32,000 capital contribution was *de minimis* as a matter of law and failed to satisfy the substantiality element. Ironically, the bankruptcy court in *Haskell Dawes* denied confirmation of the plan of reorganization based upon the debtor's failure to satisfy the substantiality element of the new value exception or corollary. Indeed, the factors considered by the bankruptcy court in *Haskell Dawes* included, *inter alia*, the size of the capital contribution, its relation to the amount of unsecured claims against the estate and the

amount of the debt to be discharged. *Haskell Dawes*, 119 B.R. at 9875. The bankruptcy court in *Haskell Dawes* concluded that the mathematical relationship of these various factors neither compelled a finding of substantiality nor lack of substantiality. *Haskell Dawes*, 199 B.R. at 876. In stark contrast, however, the mathematical relationship of these various factors compelled the Ninth Circuit in *Ambanc* to find that the $32,000 capital contribution was *de minimis* as a matter of law and failed to satisfy the substantiality element.[9]

CONCLUSION

For all the foregoing reasons, Respondent respectfully urges the Court to deny the Petition for Writ of Certiorari.

Respectfully submitted,

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[9] The Ninth Circuit in *Ambanc* declined to define a bright-line rule but instead held that the $32,000 capital contribution, which equates to less than one half of one percent of each of the various quantities judicially recognized as relevant to the substantiality comparison falls within the *de minimis* range. *Ambanc*, 115 F.3d at 656.